

**Office of Chief Counsel
Internal Revenue Service**

memorandum

CC:TEGE:GLGC:POSTF-112993-02
DSWeiner

date: March 20, 2002

to: Director (LMSB Appeals), Area 3, Chicago
Attn: Mary Nystedt

from: Area Counsel (TEGE), Great Lakes/Gulf Coast Area

subject: [REDACTED] Corporation
Availability of Interest Free Adjustments

This memorandum is in response to your request for our views concerning the availability of interest free adjustments for [REDACTED] Corporation.

DISCLOSURE STATEMENT

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views. This memorandum should not be cited as precedent.

Issue

Whether a taxpayer can make an interest free adjustment of underpaid employment taxes discovered during an examination by the Service after the Service made notice and demand for payment of those additional taxes and after Appeals completed its consideration of the case (although Appeals may give additional consideration to the case due to the taxpayer's request for mediation).

Conclusion

The taxpayer cannot make an interest free adjustment of additional employment taxes discovered during an examination by the Service because the taxpayer failed to adjust for the additional taxes prior to the end of Appeals consideration of the case and prior to receiving notice and demand for payment of those additional taxes.

Facts

The Service examined the employment tax returns of [REDACTED] Corporation (the "taxpayer") for the tax periods in [REDACTED], [REDACTED], and [REDACTED]. In the course of that examination, the examiner found that certain fringe benefits constituted additional wages subject to employment taxes.

There were two types of fringe benefits that the examiners recharacterized as wages. The first issue involved the valuation of [REDACTED] that an employee could purchase at a discount. The [REDACTED] could be used by [REDACTED]. The second issue was the valuation of [REDACTED] given to employees for [REDACTED] and [REDACTED] and [REDACTED] taxpayer. The additional wages amounted to \$ [REDACTED] in [REDACTED], \$ [REDACTED] in [REDACTED], and \$ [REDACTED] in [REDACTED].

The taxpayer apparently protested the additional employment taxes arising from the determination of additional wages by the revenue agent. The case was then considered by Appeals in Milwaukee.

The taxpayer met with the Appeals Officer. After considering the case, the Appeals Officer sustained the revenue agent's determinations. The Appeals Officer sent a letter to the taxpayer stating that he planned to sustain the revenue agent's findings. He gave the taxpayer two weeks to submit a response.

When the taxpayer failed to submit a response within the allotted time, the Appeals Officer closed case and sent it for assessment. Although the facts presented does not include the date that the notice and demand for payment was issued, we assume that it was issued on or about the date of assessment.

The Service and the taxpayer apparently agreed to extend the limitations periods on assessment of additional employment taxes to a date in [REDACTED]. The additional taxes were assessed prior to the expirations of the limitations periods. The parties did not extend the limitations periods beyond [REDACTED].

After assessment of the tax, the taxpayer requested that the issues be submitted for mediation.¹ The taxpayer requested that

¹The mediation process for Appeals is described in Announcement 98-99, 1998-2 C.B. 652, as amended by Announcement 2001-9, 2001-3 I.R.B. 357. Under the terms described in the Announcements, mediation is available for resolving factual issues (such as valuation, reasonable compensation and transfer

it be given opportunity to get an interest free adjustment at the conclusion of the mediation process.

Discussion

Section 6205 of the Internal Revenue Code provides that underpayments of FICA taxes, RRTA taxes, or income tax withholding can be adjusted without interest in accordance with the procedures provided in regulations. This is known as an interest free adjustment.

The time for making an interest free adjustment has passed even if Appeals continues to consider the case.

Under the provisions of § 31.6205-1(b)(2)(i), when FICA taxes are found to be underpaid after the filing of the employment tax return for the period in which the wages are paid, the employer can make an interest free adjustment (a) by reporting the additional amount due by reason of the underpayment as an adjustment on a return filed on or before the last day on which the return is required to be filed for the return period in which the error is ascertained, or (b) by reporting such additional amount on a supplemental return for the return period in which such payment of wages or compensation is made that is filed on or before the last day on which the return is required to be filed for the return period in which the error is ascertained.

For underpayments of income tax withholding discovered after the year in which the wages were paid, § 31.6205-1(c)(2) provides that the taxpayer can make an interest free adjustment by reporting the additional tax on a supplemental return for the return period in which such wages were paid. The supplemental return must be filed on or before the last day on which the return is required to be filed for the return period in which the error was ascertained.

Section 31.6205-1(a)(4) provides that an error is ascertained, for purposes of § 6205, when the employer has sufficient knowledge of the error to be able to correct it.

pricing) involving an adjustment of \$ 1 million or more, arising from examination. Because the adjustments in this case are significantly less than \$1 million, this case does not appear to be eligible for mediation.

In Rev. Rul. 75-464, 1975-2 C.B. 474, the Service ruled that if the error is discovered in the course of an examination by the Service, the taxpayer can make an interest free adjustment by agreeing to the adjustment on Form 2504, Agreement to Assessment and Collection of Additional Tax and Acceptance of Overassessment prior to the close of any administrative appeal. The Form 2504 agreement constitutes a supplemental return for the purposes of § 31.6205-1.

In Lowen Corporation v. United States,, 72 AFTR 2d 93-6350 (D. Kan. 1993), aff'd sub. nom., Eastern Investment Corp. v. United States, 49 F.3d 651 (10th Cir. 1995), the court ruled that the taxpayer had sufficient knowledge of an error when its appeal was denied by the Service. The court defined "sufficient knowledge" as having a clear and final understanding of the Service's position regarding the error. The Tenth Circuit found that the taxpayer had sufficient knowledge when the Appeals Office notified the taxpayer of its determination. Eastern Investment Corp. v. United States at 657.

The taxpayer contends that it can make an interest free adjustment based upon the examination results in this case because the case is still under Appeals consideration. This case remains under Appeals consideration only because the taxpayer requested additional consideration. The administrative appeal ended for the purposes of § 6205 when he Appeals Officer sent his letter to the taxpayer stating his decision to sustain the findings of the examiner and to assess the tax and when the taxpayer failed to respond to that letter timely.

A taxpayer cannot make an interest free adjustment after receipt of a notice and demand for payment.

Under the provisions of § 31.6205-1(a)(6)(i) of the employment tax regulations, a taxpayer cannot make an interest free adjustment after receipt of notice and demand for payment based upon an assessment.

Under the provisions of § 6303, the Service makes a valid notice and demand for payment by stating the amount of the liability and demanding payment thereof and either leaving the notice at the dwelling or usual place of business of the taxpayer or mailing the notice to the taxpayer's last known address.

In this case, the taxpayer failed to adjust for the underpayment or to agree to the assessment of the additional employment taxes prior to the notice and demand for payment of the additional employment taxes. Because the taxpayer did not

sign a Form 2504 agreement (or any way adjust its employment tax liability for the periods at issue) prior to receipt of the notice and demand for payment, the taxpayer cannot make an interest free adjustment. The normal interest provisions under § 6601 apply from the due date of the Forms 941 for the periods in which the additional wages were paid.

Some argued that the assessment and the notice and demand for payment in this case were premature. They reasoned that the taxpayer was not given a sufficient opportunity to make its case in Appeals. We note that the taxpayer met with the Appeals Officer and presented its case. Based upon the contents of the Appeals Officer's Appeals Case Memo, the Appeals Officer fully considered the taxpayer's arguments. The Appeals Officer notified the taxpayer of his determination to sustain the adjustments and to assess the tax. The taxpayer failed to respond within the time requested by the Appeals Officer. The assessment does not appear to have been premature.

There is no obligation on the part of the Appeals Officer to inform the taxpayer that its failure to sign an agreement prior to assessment forecloses its ability to make an interest free adjustment under § 6205.² Section 31.6205-1 requires that the taxpayer make the timely adjustment for adjustment to qualify as interest free.

Conclusion

The taxpayer cannot make an interest free adjustment of additional employment taxes discovered during an examination by the Service because the taxpayer failed to adjust for the additional taxes prior to the end of Appeals consideration of the case and prior to receiving notice and demand for payment of those additional taxes.

If you have any questions, please call David Weiner at (312) 886-9225, ext. (b)(6)

²We note that this is a sophisticated taxpayer that would ordinarily be responsible for making its own arguments concerning its liability.

/s/Judith M. Picken

JUDITH M. PICKEN
Area Counsel (TEGE)